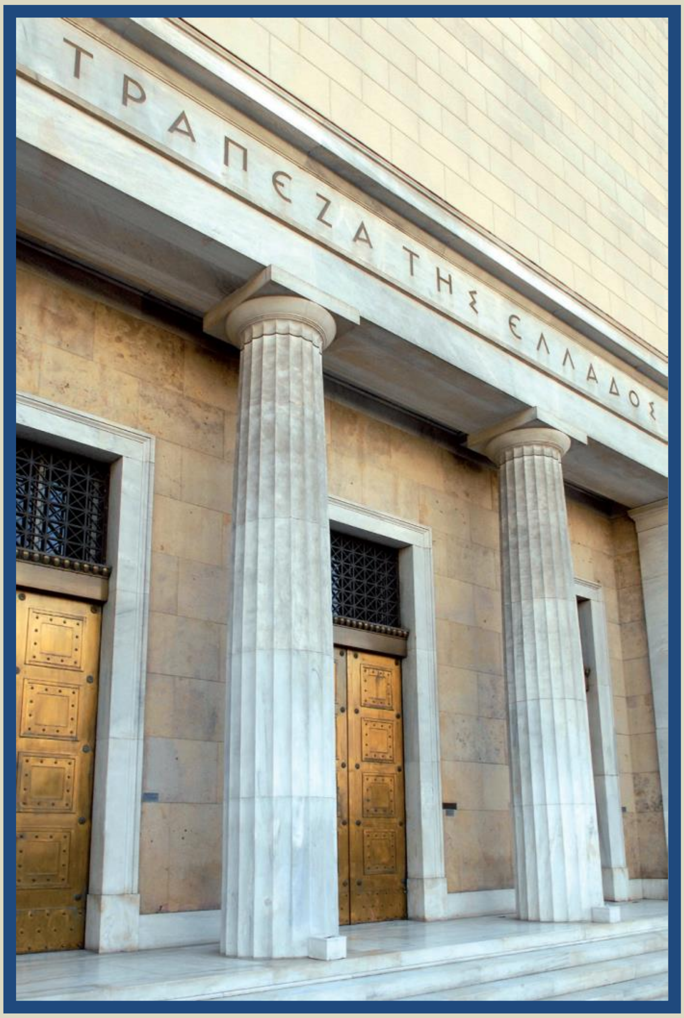
FINANCIAL STABILITY REVIEW

EXECUTIVE SUMMARY



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EUROSYSTEM

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I. EXECUTIVE SUMMARY

The macroeconomic environment and geopolitical risks affect financial stability. In 2024, steady disinflation in the euro area and the economic recovery, albeit weaker than anticipated, led to a moderation of risks. Nevertheless, the current high valuations in money and capital markets accentuate the risk of a sharp repricing of assets. The interconnectedness of the government, corporate and financial sectors at international level is also a source of concern. The short-lived financial turmoil in August 2024 that was triggered mainly by the Japanese central bank's decision to increase its policy rates[1] brought to the fore this risk and highlighted the growing importance of the non-bank financial sector. Moreover, geopolitical risks from Russia's invasion of Ukraine, compounded by the recent conflicts in the Middle East, could weigh heavily on global economic growth and push up energy prices, implying an exogenous risk factor for the banking sector.

In the first half of 2024, the Greek economy maintained its growth momentum. Real gross domestic product (GDP) growth in Greece stood at 2.2% in the first half of 2024, mainly driven by consumption, while the external sector of the economy as a whole contributed negatively. The labour market also continued to improve further, with the unemployment rate falling to 10.9% in the first half of 2024 (from 11.5% in the first half of 2023).[2] Inflation, measured by the Harmonised Index of Consumer Prices (HICP), gradually declined, standing at 3.0% in January-September 2024, against 4.4% in the corresponding period of 2023. However, HICP excluding energy rose at a faster pace, reflecting upward pressures on food prices, as well as on the prices of non-energy industrial goods and services, thus affecting business operating costs and household disposable income. Tax revenue overperformance in January-August 2024 was a positive development, with the general government primary balance estimated at a surplus of 3% of GDP, up from 2,4% of GDP in 2023.

In the first half of 2024, the key fundamentals of the Greek banking sector remained at a satisfactory level. Bank profitability improved further, bank liquidity remained high, while capital adequacy was almost unchanged. Against this background, banks distributed dividends for the first time in fifteen years,[3] nevertheless implementing a prudent dividend policy. Moreover, throughout 2024, banks' credit rating upgrades by international rating agencies continued,[4] as did the disinvestment of the Hellenic Financial Stability Fund (HFSF) from the Greek significant institutions.[5]

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[1] The announcement of weaker than anticipated employment and manufacturing figures for the US also contributed to this turmoil.

[2] The seasonally adjusted unemployment rate in August 2024 stood at 9.5%, against an upward revised 11.4% in August 2023 and 9.9% in July 2024 (Hellenic Statistical Authority).

[3] It should be noted that since 2014, when the Single Supervisory Mechanism (SSM) was launched, a dividend ban had been imposed on Greek banks.

[4] On 4 September 2024, S&P Global Ratings upgraded the long-term rating of Alpha Bank from BB to BB+, with stable outlook, while on 6 September, Fitch Ratings upgraded by one notch the Long-Term Issuer Default Rating of all four Greek significant institutions.

[5] Since October 2023, the Hellenic Financial Stability Fund has fully disinvested from Piraeus Bank, Alpha Bank and Eurobank, while maintaining an 8.39% stake in the capital of National Bank of Greece and a 72.54% stake in Attica Bank.

The liquidity of the Greek banking sector remained at a high level. The balance of residents' deposits in Greece in August 2024 amounted to EUR 201.9 billion, marginally up from December 2023, with liquidity ratios remaining above prudential requirements. Specifically, the Liquidity Coverage Ratio (LCR) stood at 209.3% in June 2024, from 220.7% in December 2023; the Net Stable Funding Ratio (NSFR) was 133.8% in June 2024, from 135.2% in December 2023; and the Asset Encumbrance Ratio improved significantly, dropping to 8.5% in June 2024, from 13.2% in December 2023. In anticipation of the 2025 deadline, Greek banks have implemented measures to ensure compliance with the Minimum Requirements for Own Funds and Eligible Liabilities (MREL). In January-September 2024, the Greek significant institutions issued senior preferred bonds of a nominal value of EUR 3,750 million, subordinated bonds of a nominal value of EUR 2,450 million and Additional Tier 1 instruments of a nominal value of EUR 300 million.

The quality of credit institutions' loan portfolios deteriorated marginally due to a one-off adjustment. Specifically, the total stock of non-performing loans (NPLs) reached EUR 10.4 billion in June 2024, up by 4.8% or EUR 476 million from December 2023, according to on-balance-sheet data on a solo basis.[6] This was mainly due to the inclusion within the NPL perimeter – pursuant to a supervisory requirement – of certain government-guaranteed loans. The ratio of NPLs to total loans in June 2024 rose marginally to 6.9%, from 6.7% in December 2023, as credit expansion mitigated the negative effect from the increase in NPLs. Thus, the system-wide NPL ratio remains high and a multiple of the European average (June 2024: 2.3%[7]) and efforts to reduce the legacy NPL stock must continue. In addition, the less significant institutions NPLs ratio remains particularly high, standing at 36.4% in June 2024. It should be noted that, by the end of 2024, this ratio is expected to drop substantially for the less significant institutions thanks to the inclusion in the "Hercules" government guarantee scheme of NPLs from the new entity created following the merger between Attica Bank and Pancreta Bank.

Greek banking groups' core profitability improved significantly. In the first half of 2024, Greek banks' profits after tax and discontinued operations amounted to EUR 2.3 billion, compared with profits of EUR 1.9 billion in the first half of 2023. Underlying this development were most importantly an increase in net interest income as a result of high key European Central Bank (ECB) interest rates and a decrease in loan-loss provisions. In detail, in the first half of 2024, the operating income of Greek banking groups increased by 10.8% compared to the first half of 2023. Net interest income grew by 11.4%, benefiting from the ECB's key interest rate hikes from July 2022 until September 2023, as the biggest part of the loan portfolio carries variable interest rates. In the same vein, net fee and commission income increased by 15.9%, supported by fees from payment transactions and asset management. As a result, core operating income (i.e. net interest income and net fee and commission income) grew by 12.2%. Gains from financial transactions also grew in the first half of 2024, thanks to gains from transactions in Greek government bonds and derivatives and hedging products. By contrast, other operating results dropped, burdened by

[6] On a consolidated basis, the stock of NPLs stood at EUR 10.6 billion, up by 4.3% or EUR 0.4 billion, from EUR 10.2 billion at the end of 2023.
[7] Source: Single Supervisory Mechanism (SSM).

one-off expenses in the first half of 2024. The cost of credit risk[8] declined significantly in the first half of 2024 to 0.7% of net loans. As a result, Greek banking groups posted profit after tax and discontinued operations, and the Return on Assets (RoA) and Return on Equity (RoE) ratios came to 1.5% and 13.8%, respectively.

The capital adequacy of the banking sector remained almost unchanged in the first half of 2024, as a rise in prudential own funds was offset by an increase in risk-weighted assets. In particular, the Common Equity Tier 1 (CET1) ratio on a consolidated basis fell marginally to 15.4% in June 2024, from 15.5% in December 2023, and the Total Capital Ratio (TCR) remained unchanged at 18.8%. These indicators are below the EU average (CET1: 15.8% and TCR: 19.9% in June 2024).[9] Moreover, the quality of Greek banks' prudential own funds remains low: in June 2024, Deferred Tax Credits (DTCs) amounted to EUR 12.5 billion, representing 41% of total prudential own funds (against 44% in December 2023) and 50% of CET1 capital (against 53% in December 2023).

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In the current macroeconomic and financial environment, implementing an appropriate macroprudential policy to avoid the build-up of systemic risks and to enhance the resilience of the banking sector is all the more important. The Bank of Greece conducts a quarterly assessment of the intensity of cyclical systemic risks and the appropriateness of the Countercyclical Capital Buffer (CCyB) rate for Greece and sets or adjusts it, if necessary. The analysis of the additional indicators examined by the Bank of Greece confirms that overall, there is no excessive credit growth, however it points to emerging cyclical systemic risks in certain areas, such as credit to non-financial corporations, residential real estate prices and the current account. Furthermore, the stable macroeconomic environment, Greece's upgrade to investment grade and the banking sector's improved fundamentals and prudential indicators establish favourable conditions for creating adequate macroprudential space to safeguard financial stability over the medium term. In this context, by Executive Committee Act (ECA) 235/1/07.10.2024, the Bank of Greece introduced a positive neutral rate of the countercyclical capital buffer (PNR CCyB), which is activated in a standard risk environment, i.e. when cyclical systemic risks are neither subdued nor elevated. It thus allows institutions to absorb potential losses and maintain a smooth flow of credit to the real economy in the event of adverse shocks. Moreover, the target PNR CCyB for Greece has been set at 0.5%. In light of the above, the Bank of Greece set the countercyclical capital buffer rate for Greece at 0.25%, applicable from 1 October 2025.

In addition, the Bank of Greece identified Other Systemically Important Institutions (O-SIIs) in Greece for the year 2024, applying the relevant European Banking Authority (EBA) guidelines, and set the O-SII buffer rate for 2025 at 1.25% for Eurobank Ergasias Services and Holdings S.A. on a consolidated basis and at 1.00% for all other O-SIIs.

[8] Cost of credit risk is the ratio of credit risk provisions over loans after accumulated provisions.
[9] Source: Single Supervisory Mechanism (SSM).

Finally, the Bank of Greece has enacted macroprudential borrower-based measures (BBMs) for loans and other credit to natural persons secured by residential real estate located in Greece, effective as of 1 January 2025. In more detail, ECA 227/1/08.03.2024 introduced a cap on the loan-to-value ratio at origination (LTV-O) of 90% for first-time buyers and 80% for second and subsequent borrowers, as well as a cap on the debt service-to-income ratio at origination (DSTI-O) of 50% for first-time buyers and 40% for second and subsequent borrowers. Up to 10% of the total number of new loans and other credit can be exempted from the above LTV-O and DSTI-O caps.

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For the first half of 2024, the Greek insurance market, despite challenges associated with the international macroeconomic and financial environment and climate change, maintained its capital adequacy almost at the same level as at end-2023. Insurance undertakings continued their efforts to address both existing and emerging risks, adapting their business models and reviewing, where necessary, their pricing and investment policies. This adaptation strategy testifies to the flexibility and resilience of the Greek insurance market in a constantly changing environment.

The smooth operation of financial market infrastructures, i.e. payment, clearing and settlement systems, contributed positively to the stability of the domestic financial system through the efficient processing of transactions. As regards the electronic means of payment used, in the first half of 2024 both the volume and value of credit transfers and direct debits maintained their upward trend, while no significant changes were observed to card payment transactions. The fraud-to-transaction ratios in terms of number and value of fraud incidents decreased as regards to card payment transactions and significantly decreased for credit transfers.

In June 2024, the total value of exposures[10] under management by Credit Servicing Firms (CSFs) amounted to EUR 86.3 billion, of which 81% relates to exposures managed by CSFs on behalf of Credit Purchasers[11] and the remaining 19% concerns the management of exposures on behalf of credit institutions. The portfolio of exposures under management in June 2024 consisted mainly of NPLs (83%) and, to a lesser extent, performing exposures (17%).

According to the revised framework (Law 5072/2023) on credit servicers and credit purchasers, CSFs authorised under Article 1 of Law 4354/2015 (Government Gazette A 176)[12] needed to be assessed by the Bank of Greece for compliance with the provisions of the new framework before being re-authorised. The Bank of Greece has authorised until now14 CSFs,

[10] Exposures include all debit instruments (loans and advances and debt securities), excluding off-balance-sheet exposures and write-offs. It should be noted that Bank of Greece Executive Committee Act 206/1/03.06.2022 (available only in Greek) modified, inter alia, supervisory data and information to be submitted by CSFs to the Bank of Greece.

[11] Any discrepancies between the supervisory data analysed in this section of the Financial Stability Review and the data regularly published by the Bank of Greece on its website are mainly due to the different perimeter of each data release.

[12] The Bank of Greece had authorised a total of 26 CSFs, of which 3 had ceased operations before the launch of the re-authorisation process.

extended the licenses of 4 existing CSFs until the end of 2024, and withdrew 5 licenses after their holders had voluntarily relinquished them.

The business of Payment Institutions (PIs) and Electronic Money Institutions (EMIs) grew in 2024. The total value of payment transactions carried out by PIs in the 2024 reference period (from 01.07.2023 to 30.06.2024) amounted to EUR 60.5 billion, up by 4% against 2023[13] (EUR 58.2 billion). In the same vein, the total annual value of payment transactions carried out by EMIs stood at EUR 29.7 billion, up by 11% compared to 2023 (EUR 26.8 billion). These developments had a positive impact on the own funds and profitability of PIs and EMIs.

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The outlook for the Greek economy is positive. According to the Bank of Greece's most recent estimates,[14] real GDP growth is projected to stand at 2.2% in 2024 (from 2.3% in 2023) and accelerate to 2.5% in 2025. The utilisation of funds under the Recovery and Resilience Facility is expected to help achieve sustainable growth rates for real GDP and total factor productivity. Higher investment is a prerequisite for accelerating economic growth. Strengthening the banks' intermediation function would also help in this direction.

The outlook for the banking sector is inevitably linked to Greece's macroeconomic trajectory, which is in turn also affected by international developments. A deterioration in international financial conditions could have adverse effects both on the global financial system and on the financial situation of firms and households at the domestic level. Moreover, on the single monetary policy front, as the ECB gradually cuts its key interest rates, banks' core profitability may be negatively affected, especially if they fail to meet their credit growth targets. At the same time, a definitive resolution of the remaining NPL stocks and a convergence of the NPL ratio to the European average remain a challenge, as well as addressing climate change and cyber attack risks. It should be noted that the latter risk is closely associated with geopolitical tensions and, therefore, effectively tackling it calls for international cooperation and further investigation of financial system interconnections.

Safeguarding financial stability also largely depends on promoting reforms at European Union (EU) level. Heightened geopolitical risks due to the proliferation of armed conflicts, as well as political developments associated with the upcoming presidential election in the United States exacerbate uncertainty. Thus, in an environment of intensifying exogenous factors, with strong interconnections and rapid transmission of risks, it is now evident that promoting reforms with the aim to remove inherent weaknesses at EU level is a priority. The set-up of a common European Deposit Insurance Scheme (EDIS) at Banking Union level is deemed necessary to strengthen depositors' confidence, especially in case of cross-border turmoil and systemic crisis. The introduction of a common framework for Crisis Management and Deposit Insurance (CMDI)

[13] Reference period: 01.01.2023-31.12.2023.
[14] These estimates have not taken into account the second estimate of the Annual National Accounts for the year 2023 and the revised figures for the years 1995-2022, which were announced by the Hellenic Statistical Authority on 17.10.2024.

should facilitate the integration of the currently fragmented banking sector in the EU. In this context, the implementation of the policy proposals outlined in the Draghi Report[15] is expected to help resolve competitiveness issues facing the EU on the one hand, and on the other hand, ensure a level playing field for all European banks, as they would all be subject to a single regulatory and resolution framework.[16] However, the positive impact from the proposed actions depends on the extent to which they will be implemented. Lastly, in the context of bolstering the competitiveness of euro area banks, cross-border initiatives[17] aiming at bank consolidation and the creation of entities with critical size on a global scale are assessed positively.

[15] Draghi Report September 2024.

[16] The Draghi proposals aim at improving the functioning, productivity and competitiveness of the EU as a whole, rather than of a specific group of countries or of individual sectors.

[17] An indicative example is the acquisition by Italy's UniCredit of a significant equity stake in Germany's Commerzbank.

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